INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statutes involved	2
Statement	2
Reasons for granting the writ	6
Conclusion	14
Appendix A	15
Appendix B	38

CITATIONS

Cases:

Aquilino v. *United States*, 3 N. Y. 2d 511	13, 14
Berry, Charles W., Houses (Aetna Casualty & Surety Co.) v. *United States*, decided April 30, 1958 (App. N. Y.)	14
Brick Co. v. *Pulley*, 168 N. C. 371	11
Fidelity & Deposit Co. v. *New York City Housing Auth.*, 241 F. 2d 142	12, 13
Foundry Co. v. *Aluminum Co.*, 172 N. C. 704	11
Hardware Co. v. *Schools*, 151 N. C. 507	11
Powder Co. v. *Denton*, 176 N. C. 426	11
United States v. *Acri*, 348 U. S. 211	7
United States v. *Bess*, 357 U. S. 51	13
United States v. *Colotta*, 350 U. S. 808, reversing 79 So. 2d 474 (Miss.)	7, 8, 14
United States v. *Gilbert Associates*, 345 U. S. 361	7, 9
United States v. *Hulley*, No. 300, this Term, decided November 10, 1958, reversing 102 So. 2d 599 (Fla.)	7, 8, 14
United States v. *Kings County Iron Works*, 224 F. 2d 232	13
United States v. *Liverpool & London Ins. Co.*, 348 U. S. 215	7
United States v. *New Britain*, 347 U. S. 81	7, 8, 9
United States v. *Scovil*, 348 U. S. 218	7, 9
United States v. *Security Tr. & Sav. Bk.*, 340 U. S. 47	7, 9, 12

Cases—Continued

	Page
United States v. *Vorreiter*, 355 U. S. 15, reversing 134 Colo. 543	7, 8, 14
United States v. *White Bear Brewing Co.*, 350 U. S. 1010, reversing 227 F. 2d 359	7, 8, 14
Widenhouse v. *Russ*, 234 N. C. 382	11

Statutes:

Internal Revenue Code of 1954:	
Sec. 6321 (26 U. S. C. 1952 ed., Supp. V, Sec. 6321)	8, 38
Sec. 6322 (26 U. S. C. 1952 ed., Supp. V, Sec. 6322)	38
Sec. 6323 (a) (26 U. S. C. 1952 ed., Supp. V, Sec. 6323 (a))	8, 9, 38
General Statutes of North Carolina (Recompiled 1950):	
Sec. 44–1	39
Secs. 44–6 to 44–14	11
Sec. 44–6	11, 39
Sec. 44–8	11, 40
Sec. 44–9	40
Sec. 44–10	41
Sec. 44–11	11, 41
Sec. 44–38	42
Sec. 44–39	42
Sec. 44–43	11, 42
Sec. 44–48	11, 42

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In the Supreme Court of the United States

OCTOBER TERM, 1958

No. ——

UNITED STATES OF AMERICA, PETITIONER

v.

DURHAM LUMBER COMPANY, A CORPORATION, AND GEORGE H. CARTER, JR., FORMERLY TRADING AS DIXIE CONCRETE AND SUPPLY COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fourth Circuit.

OPINIONS BELOW

The memorandum opinion of the District Court (Appendix A, *infra,* pp. 23–25) is not officially reported. The opinion of the Court of Appeals (Appendix A, *infra,* pp. 26–35) is reported at 257 F. 2d 570.

JURISDICTION

The judgment of the Court of Appeals was entered on July 18, 1958. (Appendix A, *infra,* p. 36.) By order of the Chief Justice, dated October 10, 1958,

the time for filing a petition for a writ of certiorari was extended to and including December 15, 1958. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

QUESTION PRESENTED

Whether, in the distribution of a fund determined by state court judgment to be owing to the taxpayer, a state "statutory right to payment" is entitled to priority over a federal tax lien which arose and was recorded before the "statutory right to payment" first came into existence.

STATUTES INVOLVED

Sections 6321, 6322, 6323 of the Internal Revenue Code of 1954, and Sections 44–1, 44–6, 44–8, 44–9, 44–10, 44–11, 44–38, 44–39, 44–43, and 44–48 of the General Statutes of North Carolina (Recompiled 1950) are set forth in Appendix B, *infra,* pp. 38–43.

STATEMENT

This case arises from bankruptcy proceedings in the District Court for the Middle District of North Carolina. At issue is the relative priority of federal tax liens and the claims of certain subcontractors to a fund recovered by the trustee in bankruptcy as the balance due on a construction contract to a general contractor who is indebted to the United States for unpaid withholding and social security taxes. (Appendix A, *infra,* p. 21.) The facts are undisputed and may be stated as follows:

The taxpayer-bankrupts are two individuals (Michael and Embree) who were doing business as

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general contractors in and around Durham, North Carolina. On July 15, 1954, they completed construction of some camp buildings for certain persons who will be referred to herein as "owners". (Appendix A, *infra,* pp. 16–17.) Shortly thereafter, on August 13, 1954, and November 22, 1954, federal withholding and unemployment insurance taxes were assessed against the taxpayers in the respective amounts of $4,017.53 and $3,254.73. A notice of lien for the first amount was filed in the office of the Register of Deeds of Durham County on November 2, 1954. (Appendix A, *infra,* p. 19).

Respondent Dixie Concrete and Supply Company gave notice to the owners of its claim for $3,089.54 on January 12, 1955, and respondent Durham Lumber Company gave notice to the owners of its claim for $366.93 in February, 1955. (Appendix A, *infra,* p. 18.)[1] Neither respondent, however, brought suit within six months, as required by North Carolina law in order to perfect a mechanic's lien. (Appendix A, *infra,* p. 35.)

On January 18, 1955, the taxpayers were adjudicated bankrupts in the United States District Court (hereinafter called "the Bankruptcy Court"). At that time there was an unpaid balance of $5,250 due from the owners to the taxpayer-bankrupts under the construction contract. The owners, however, disputed

[1] Another subcontractor, the Durham Brazing & Welding Company, whose claim is not involved here, gave notice of its claim to the owners on June 20, 1955. Five other subcontractors claiming liens, but whose claims likewise are not involved here, did not give any notice to the owners. (Appendix A, *infra,* p. 18.)

the amount and contended that there was nothing due. The trustee in bankruptcy instituted suit against the owners in the Superior Court of Durham County, North Carolina, and obtained a jury verdict for the disputed amount. Judgment on the verdict was entered on June 7, 1956. (Appendix A, *infra*, p. 17.)

Thereupon the owners petitioned the Bankruptcy Court for permission to pay subcontractors who had furnished materials in connection with the construction work and had given notice of that fact to the owners, but who had not been joined as parties in the trustee's action. Extensive negotiations were had between the trustee, the owners, and the subcontractors, two of which (the Adams Concrete & Block Company and Nolan & Company) had instituted separate actions against the owners. Eventually, the owners moved to reopen the proceedings in the state court and made the subcontractors parties. The Nolan Company also filed a petition in the Bankruptcy Court for permission to make the trustee a party to its action. Finally, a compromise agreement, approved by the Bankruptcy Court, was effected whereby the claims of the Adams Company and the Nolan Company were settled for a total of $465.63, to be paid from the amount of the judgment obtained by the trustee against the owners. The order of the state court required the owners to pay over to the trustee the balance due, and transferred the liens to the fund and discharged the owners from the claims of the lien claimants. Thereupon the owners paid to the trustee the amount of the judgment, $5,250, plus interest of

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$250. It was understood among the parties that their rights in this fund would be determined in the Bankruptcy Court the same as if they were in the state court. The Director of Internal Revenue was never a party to any of these actions. (Appendix A, *infra*, pp. 17–18.)

The Referee in Bankruptcy determined that the fund should first be applied to pay trustee's commission, his attorney's fee, the compromise settlement, and court costs, in the total amount of $1,885.63 (leaving a balance of $3,614.37, less than the amount of the first federal lien). Second priority was accorded to the tax claims of the United States on the ground that its liens were prior to those of the three subcontractors which were not involved in the compromise settlement and which had notified the owners of their claims. These three subcontractors—the two respondents and a third subcontractor whose claim is not involved here [2]—were accorded a third priority on a *pro rata* basis. The remaining five subcontractors were held not to have liens on the proceeds since they had not given notice of their claims to the owners as required by the laws of North Carolina. (Appendix A, *infra*, pp. 19–20.)

The only adverse claimants which filed exceptions to the order of the Referee, insofar as that order granted priority to the tax liens of the United States as against their claims, were the two respondent subcontractors. (Appendix A, *infra*, p. 23.) The District Court allowed the exceptions and modified the order

[2] See note 1, *supra*.

of the Referee accordingly. (Appendix A, *infra*, pp. 23–25.) The Court of Appeals for the Fourth Circuit affirmed the decree of the District Court. (Appendix A, *infra*, pp. 26–37.)

The Court of Appeals, although relying on the North Carolina lien statutes, acknowledged that "The rights of the subcontractors as here asserted against the owners are not liens. Each of them acquired a lien on the real estate of the owner when he gave notice of his claim, but no one of them instituted an action to foreclose the lien within six months after the notice, and they may not now do so. But their statutory right to payment by the owners persists and may be enforced by them. Their claims are preferred to that of the general contractor, but, with respect to others, their standing is that of a common creditor of the owners." (Appendix A, *infra*, p. 35.) This "statutory right to payment," the court held, is entitled to priority over the federal liens.

REASONS FOR GRANTING THE WRIT

The two federal tax liens involved here arose before either respondent's "statutory right to payment" had arisen. In addition, the first of the two federal liens was *recorded* before either respondent's "statutory right to payment" had arisen, and this federal lien is of an amount greater than the fund now in issue. In both respects, therefore, the decision of the court below, holding that respondents' claims are entitled to priority over the federal liens, is in direct conflict with numerous decisions of this Court, in particular the recent decision in *United States* v. *Hulley*, No. 300, this Term, decided November 10, 1958 (27 U. S. L.

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Week 3148), summarily reversing 102 So. 2d 599 (Fla.).

In view of this conflict, and in view of the continuing importance of the question presented, we submit that review and reversal of the decision below are fully warranted in order to preserve uniformity in the federal scheme of taxation. See *United States* v. *Gilbert Associates,* 345 U. S. 361, 364.

1. Even in the case where a mechanic's lien is recorded before the federal lien arises, this Court has held that the federal lien takes priority if additional steps are necessary to perfect the mechanic's lien. *United States* v. *Colotta,* 350 U. S. 808, summarily reversing 79 So. 2d 474 (Miss.); *United States* v. *White Bear Brewing Co.,* 350 U. S. 1010, summarily reversing 227 F. 2d 359 (C. A. 7th); *United States* v. *Vorreiter,* 355 U. S. 15, summarily reversing 134 Colo. 543.[3]

The decision below is not only in conflict with those holdings, but goes considerably further; for, as already noted, the first federal lien here arose and was recorded before either "statutory right to payment"

[3] These decisions applied the rationale of *United States* v. *Security Trust & Savings Bank,* 340 U. S. 47, that the effect of a local statutory lien in relation to the federal tax lien is always a federal question; that a prior inchoate lien under state law cannot take preference over a subsequent federal tax lien; and that the local lien remains inchoate, and unperfected in this sense, while it is "contingent upon taking subsequent steps for enforcing it" (340 U. S. at 51). This rationale was also reaffirmed in *United States* v. *Acri,* 348 U. S. 211; *United States* v. *Liverpool & London Ins. Co.,* 348 U. S. 215; and *United States* v. *Scovil,* 348 U. S. 218. See also *United States* v. *New Britain,* 347 U. S. 81, 86.

had arisen. Indeed, the decision below goes further than *United States* v. *Hulley, supra,* which involved a mechanic's lien and not merely a "statutory right to payment," and where the mechanic's lien at least arose prior to the recording of the federal lien. Like *Hulley,* however, this case can be decided simply upon the basis of the fundamental principle enunciated in *United States* v. *New Britain,* 347 U. S. 81, 85, that "the first in time is the first in right." Application of this principle clearly requires a reversal of the decision below, even apart from the rationale of the *Colotta, White Bear,* and *Vorreiter* decisions, *supra.*

2. The respondents filed their claims against the owners in January and February 1955. Until those claims were filed, the respondents concededly had no claim against the owners. Several months earlier, the first federal lien (which was recorded on November 2, 1954) arose on August 13, 1954. On the latter date, this federal lien attached to "all property and rights to property, whether real or personal, belonging to" the taxpayer. Section 6321 of the Internal Revenue Code of 1954 (Appendix B, *infra,* p. 38). As the state court necessarily determined by its judgment, the owners were then indebted to the taxpayer in the amount of $5250 (plus interest); and this amount was in fact paid to the taxpayer's trustee in bankruptcy. It thus follows that the federal lien attached to the fund (or the chose in action on which it was based) long prior to the time that respondents had any "statutory right to payment."

Aside from the four categories of lienors specifically excepted by Section 6323 (Appendix B, *infra,*

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pp. 38–39)—mortgagees, pledgees, purchasers, and judgment creditors—even a genuine lien (as distinguished from respondents' "statutory right to payment") which arises subsequent in time to a federal tax lien is clearly not entitled to priority over the federal lien. *United States* v. *New Britain, supra.* And, since neither "statutory right to payment" had been reduced to judgment prior to the recording of the federal liens, Section 6323 is inapplicable here.[4] Indeed, as already pointed out, the first federal lien was recorded even before either "statutory right to payment" came into existence. The decision below thus elevates the respondents to a status which is not even enjoyed by mortgagees, pledgees, purchasers, and judgment creditors. The decision, we believe, can be justified only on the theory that a mere debt—not even rising to the level of an inchoate lien—displaces a federal lien which had previously arisen, had previously been recorded, and had previously attached to the property involved. Numerous decisions of this Court (*supra,* pp. 6–7) are all to the contrary.

3. In granting priority to respondents' "statutory right to payment" over a prior recorded federal lien, the court below recognized that "There is no doubt of the priority of the Federal tax lien over a mechanic's lien when the two liens attach to the same

[4] The four categories of Section 6323 are to be defined according to the conventional meaning of the terms. See *United States* v. *Scovil*, 348 U. S. 218, 221 ("purchaser"); *United States* v. *Gilbert Associates*, 345 U. S. 361, 364–365 ("judgment creditor"). See also *United States* v. *Security Trust & Savings Bank*, 340 U. S. 47, 52 (concurring opinion of Mr. Justice Jackson).

property". (Appendix A, *infra,* p. 28.) But the court thought it was "confronted with a different situation" here (*ibid.*); according to the court (*id.*, p. 31), it could "not ignore the facts that the tax lien reaches the properties of the general contractor, not those of the owners, and that the independent rights of the subcontractors are asserted against the owners and their properties, not against the taxpayer or its properties." Contrary to the court's statement, however, it is patent that both the tax lien and the "statutory right to payment" do relate "to the same property"—*i. e.*, the indebtedness of the owners to the taxpayer-contractor.

More specifically, from August 13, 1954 (when the federal lien arose) at least until January 12, 1955 (when the first "statutory right to payment" arose), the owners were indebted to the taxpayer-contractor and the federal lien unquestionably attached to that indebtedness. It is only by ignoring this chronology that the court could say that "the general contractor has no right which is subject to seizure under the tax lien." The contractor-taxpayer clearly had such a right at least until January 12, 1955, and the federal lien had clearly attached by that time. On the other hand, as the court below recognized, a subcontractor under North Carolina law has no right whatever against the owners prior to giving notice, and even then has only a right to have an accounting in an ordinary civil action and judgment for "the amount due the original contractor at the time of notice

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given." (Appendix B, *infra,* p. 40.)[5] When notice

[5] Liens and rights of subcontractors are set forth in Chapter 44 (entitled "Liens") of the General Statutes of North Carolina, Article 2, Section 44–6 to Section 44–14. The purpose and effect of these sections is treated in detail by the Supreme Court of North Carolina in *Foundry Co.* v. *Aluminum Co.*, 172 N. C. 704, 706–707. The court there states that the dominant ideas of the statute are that the laborer and materialman may by notice protect themselves to the extent of the contract price; that the owner shall not be liable beyond the amount due the contractor at the time the notice is given; and when a lien is once acquired upon the property "by giving notice," the amount due the contractor shall be distributed among the claimants *pro rata.* See *Widenhouse* v. *Russ*, 234 N. C. 382, 384; *Powder Co.* v. *Denton*, 176 N. C. 426, 432; *Brick Co.* v. *Pulley*, 168 N. C. 371, 375.

As the court pointed out in the *Foundry Co.* case, *supra*, the lien is acquired by notice to the owner, and the amount due the contractor at the time of notice is not a debt due by the owner in the ordinary sense, but a trust fund. The statute furnishes subcontractors "a double security"; (*a*) a lien on the property of the owner (Section 44–6, Appendix B, *infra*, pp. 39–40) [Revisal, Sec. 2019], and (*b*) then imposes upon the owner the duties of a trustee "with respect to the amount due the contractor," and requires him to distribute the amount *pro rata* among subcontractors (Section 44–11, Appendix B, *infra*, pp. 41–42) [Revisal, Sec. 2023]. The first requires an action to enforce it, but is lost, as the court below held (Appendix A, *infra*), where, as here, action is not brought upon the lien within six months (Sections 44–43 and 44–48, Appendix B, *infra*, pp. 42–43) [Revisal, Secs. 2027, 2033 (4)], while the second does not "in strictness" create a lien, but a right to have an accounting in an ordinary civil action and judgment "for the amount due by the owner to the contractor."

When written statement of the subcontractor is furnished the owner in accord with the statute (Sections 44–8 and 44–11, Appendix B, *infra*, pp. 40, 41–42) [Revisal, Secs. 2021, 2023], a direct obligation upon the part of the owner to a subcontractor may be created, upon which he may sue in his own name. However, the right to share *pro rata* in the fund due from the owner to the contractor is a statutory right, dependent upon acquiring a lien on the property by giving notice to the owner. See *Hardware Co.* v. *Schools*, 151 N. C. 507, 509.

was given in the instant case, the property was already encumbered by the paramount federal lien.*

According to the court below, "Seizure by the United States under a tax lien of the claim of the general contractor cannot extinguish the statutory rights and obligations of a subcontractor and a North Carolina owner as between each other". (Appendix A, *infra*, p. 32.) Whatever may be the validity of that proposition, it has no relevance here. The question here is, instead, whether "the statutory rights and obligations of a subcontractor and a North Carolina owner as between each other" can extinguish the "[s]eizure by the United States under a tax lien of the claim of the general contractor", where the tax lien not only arose but also was recorded even before there came into existence "the statutory rights and obligations" referred to by the court.

4. The reliance of the court below upon the decision of the Second Circuit in *Fidelity & Deposit Co.* v. *New York City Housing Auth.*, 241 F. 2d 142, even

*There is therefore no basis for the suggestion by the court below that a contrary decision might result in double liability of the owners. (Appendix A, *infra*, p. 32.) As pointed out, the North Carolina statutes limit a subcontractor's "statutory right to payment" to "the amount due the original contractor at the time of notice given." (Appendix B, *infra*, p. 40.) In the instant case, when notice was given by the respondents, the amount formerly due the taxpayer-contractor was then due to the United States, which had acquired the chose in action under its tax lien. And it is well settled that the doctrine of "relation back" cannot be used to defeat a prior federal lien. See *United States* v. *Security Trust & Savings Bank*, 340 U. S. 47, 50.

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if that decision be correct, is misplaced. There, the taxpayer-contractor breached its contract with the owner—*i. e.*, a special provision requiring payment of the laborers and materialmen as a condition precedent to receipt of any part of the contract price—and the Second Circuit held that accordingly there was no debt due to the taxpayer-contractor and that the taxpayer-contractor had no right to which the federal lien could attach. In the instant case, it is indisputable that the owners were indebted to the taxpayer-contractor. That fact, indeed, was conclusively determined by a state court judgment (*supra*, p. 4). The Government's position is thus completely in accord with *United States* v. *Bess*, 357 U. S. 51, 55, stating that the federal lien statute "creates no property rights but merely attaches consequences, federally defined, to rights created under state law * * *." See also *United States* v. *Kings County Iron Works*, 224 F. 2d 232 (C. A. 2).

With respect to *Aquilino* v. *United States*, 3 N. Y. 2d 511, 146 N. E. 2d 774, now pending on petition for certiorari, No. 132, this Term, the court below states that there "the New York Court of Appeals reached a conclusion apparently at variance with our own" but that the New York court "may have reached a different conclusion" if it had been informed of the Second Circuit's *Fidelity & Deposit* decision, *supra*. The short answer is that in the reported *Aquilino* opinion (p. 516)[7] the New York Court of Appeals cited and

[7] Although the court below cites the reported *Aquilino* opinion, it may have had reference to an unofficial slip opinion which apparently did not cite *Fidelity & Deposit*.

distinguished *Fidelity & Deposit.*[8] The only "variance" between *Aquilino* and the decision below, we submit, is that *Aquilino* is in accord with established law in this field, whereas the decision below is not.

CONCLUSION

The question presented has been authoritatively settled by this Court in several decisions. In our view, the matter is so clear as to justify the granting of certiorari and reversal of the judgment below without the need for oral argument or further briefs.[9]

Respectfully submitted.

J. LEE RANKIN,
Solicitor General.

CHARLES K. RICE,
Assistant Attorney General.

EARL E. POLLOCK,
Assistant to the Solicitor General.

A. F. PRESCOTT,
GEORGE F. LYNCH,
Attorneys.

DECEMBER 1958.

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[8] See also that court's decision in *Charles W. Berry Houses (Aetna Casualty & Surety Co.)* v. *United States*, decided April 30, 1958 (58–2 U. S. T. C., par. 9778).

[9] This was the disposition of the *Colotta*, *White Bear*, *Vorreiter*, and *Hulley* cases, *supra*, pp. 6–7.

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APPENDIX A

In the District Court of the United States for the Middle District of North Carolina

In Bankruptcy No. 1918

In the Matter of Aubrey H. Michael & Edward L. Embree, Jr., Ind. and T/A Michael & Embree, Contractors

Minutes of the Final Meeting of Creditors

Bankrupt:

The final creditors meeting in the above case was duly held at the time and place as designated in the Notice to Creditors at which time there were present the Referee, the Trustee and interested parties.

The Report of the Trustee was made available for the inspection and examination of the creditors and there were no objections made to said report.

The following fees and expenses were found to be fair and reasonable and approved and directed to be paid as follows:

Herman A. Smith, U. S. Clerk costs as per separate order	$718.48
W. Hance Hofler:	
Trustee's fee	461.29
Trustee's expenses	
Daniel K. Edwards (This includes $1,200 allocated in the lien order), Attorney for Trustee, fee	3,000.00
Expense of Trustee's Attorney	
Rufus W. Reynolds, advanced for telephone calls	7.88
Rufus W. Reynolds, travel expenses advanced	
E. K. Powe, Attorney for Bankrupt, fee	400.00
Daniel K. Edwards:	
Attorney for Petitioning Creditors, fee	200.00
Attorney for Petitioning Creditors, expenses	
Bank of Greensboro, N. C., Intangible tax for current year	10.41

Office Service Company, Preparing notices, etc., for Referee, special work			$6.10
Charles W. White, State Receiver			300.00
Total			5,104.16
It appeared that there was a balance on hand of			13,884.91
After paying the above expenses there will be a balance of			8,780.75

to be applied as far as it will go in the following order:

Wages as follows:			
Pfd. Claim No. 10	J. W. Thames	$200.00	
Pfd. Claim No. 11	J. W. Thames	52.84	
			252.84
Adams Concrete Company		135.00	
Nolan Company (arising out of obtaining judgment against McArthur & Chambers, see order below)		------	
			465.65
Director of Internal Revenue—lien as filed in Durham County, on Nov. 2, 1954			4,017.53
Director of Internal Revenue—withholding and FICA assessment date Nov. 22, 1954—lien (not filed in Durham County)			3,254.73

Material Claims Which are Liens on Chambers-McArthur Judgment after Director of Internal Revenue Lien

Claimant	*Amt. of Claim*	*20% Dividend*	
Durham Brazing & Welding Company	$360.78	$14.68	
Dixie Concrete & Supply Company	3,088.54	639.36	
Durham Lumber Company	364.93	75.96	
	3,816.25		790.00
			8,780.75

Order

Upon the petition of certain material furnishers and the claims by the Director of Internal Revenue, and after hearing the evidence, the argument of counsel, and consideration of briefs, the following facts and conclusions of law are made:

1

The bankrupts were general contractors doing business in and around Durham, North Carolina. They filed a voluntary petition in bankruptcy on January 3,

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1955, and were adjudicated bankrupts on January 18, 1955.

2

That during the first part of 1954 the bankrupts entered into a contract to build certain camp buildings for G. T. McArthur and R. L. Chambers, hereinafter referred to as "Owners". The buildings were completed on July 15, 1954. At the date of bankruptcy there was an unpaid balance of $5250.00 due from the Owners to the bankrupts on the said contract. However, the Owners disputed the amount and contended that there was nothing due.

3

The Trustee instituted suit against the Owners in the Superior Court of Durham County, North Carolina, and finally won a jury verdict of $5250.00. The judgment on the verdict was entered on June 7, 1956. Shortly after the judgment was rendered the owners petitioned the bankrupt court for permission to pay certain material furnishers or subcontractors of the bankrupts who had given the owners notice of furnishing such material. At that time it appeared to the Owners that they had failed to include in the action or join as parties in the Trustee's action the alleged subcontractors of the bankrupt. Adams Concrete Company and Nolan and Company had already instituted suits against the Owners. These two suits were not combined with the Trustee's suit.

4

Extensive negotiations went on between the Trustee, the material furnishers and the Owners. Finally the Owners made a motion in the Superior Court to reopen the proceeding and make parties the alleged material furnishers. Nolan and Company filed a petition

in the bankruptcy court for permission to make the Trustee a party to its action. Finally in Superior Court in order to get the judgment and matters settled the Trustee marked out an agreement and obtained permission of the bankruptcy court to compromise and settle the Nolan claim in the original amount of $741.25 for the sum of $300.00 plus $30.45 court costs, and settle the suit involving the Adams Concrete and Block Company which was in the original amount of $228.63 for $123.00 plus $10.00 court costs, with the understanding that this amount would be paid from the judgment collected from Chambers & McArthur. After this agreement was entered, then the Owners voluntarily paid the judgment in the amount of $5250.00 plus $250.00 interest. It was understood that the parties who might be entitled to this fund would be determined in the bankruptcy court the same as if they were in the Superior Court. The Director of Internal Revenue was never party to any of those three actions.

5

The Durham Brazing & Welding Company whose claim is in the amount of $360.70 gave notice to the Owners of its claim on June 20, 1955. The Dixie Concrete & Supply Company whose claim is $3,089.54, gave notice to the Owners on January 12, 1955. The Durham Lumber Company, whose claim is in the amount of $366.93, gave notice in February, 1955. The other subcontractors and material furnishers claiming a lien did not give any notice. They are as follows: Genn Hosiery Mill, $374.15; Gwalty Oil Company, $334.64; Lovett Electric Company, $437.50; Nello L. Teer Company, $355.07; Peedan Steel Company, $820.29.

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The Director of Internal Revenue claims a lien on the amount collected from the Owners as well as a lien on the other assets of the bankrupts by reason of withholding and F. I. C. A. taxes assessed August 13, 1954, filed in the Register of Deeds Office of Durham County on the 2nd day of November, 1954, on which there is a present balance due of $4,017.53 and a tax claim for withholding and F. I. C. A. assessed November 22, 1954, in the amount of $3,254.73. The Trustee and his attorney spent several days in trying, arguing and collecting the judgment from the Owners. Reasonable compensation which the attorney for the Trustee earned is found to be $1,200.00. The bankruptcy court costs on the amount recovered is 2%, and the Trustee's commission is 2%, making a total cost of $1,420.00 which should be allocated and paid from the judgment. This allocation and expense is included in the above attorney's fee and Trustee's fee and court costs.

CONCLUSIONS OF LAW

7

The $135.00 compromise and agreement with Adams Concrete and Block Company and the $330.63 compromise with Nolan and Company was legal and necessary and was part of the costs of procuring the settlement and judgment and that this sum should be first taken from the amount of the judgment. After then deducting the costs of obtaining the judgment, the Director of Internal Revenue has a lien prior to the liens as claimed by the Durham Brazing & Welding Company, Dixie Concrete and Supply Company and the Durham Lumber Company which position is supported by the following cases:

U. S. v. *The White Bear Brewing Co.*, 350 U. S. 1010 (1956)
U. S. v. *Collata* (1955), 350 U. S. 800
U. S. v. *Kings County Iron Works, Inc.* (C. A. 2nd 1955), 224 Fed. 232
Brust v. *Starr* (C. A. 2nd 1956), 237 Fed. 2nd 135
United States v. *England* (C. A. 9th 1955), 226 Fed. 2nd 205
United States v. *City of New Brittain* (1953), 347 U. S. 81

8

The material and subcontract claimants who did not file any notice with the Owners are not entitled to any liens on any proceeds of the judgment by reason of the fact that such notice must be given pursuant to the statutes of North Carolina before any lien is created or any right to any funds in the hands of the Owners is established.

WHEREFORE, IT IS ORDERED that after the application of the balance of the funds on hand to the lien by the Director of Internal Revenue, the unpaid balance of the liens as above computed in the minutes of the final creditors meeting be paid from the judgment from McArthur & Chambers and that the remainder after deducting the said liens by the Director of Internal Revenue be paid prorata on the claims of Durham Brazing & Welding Company, Dixie Concrete & Supply Company, and Durham Lumber Company as above indicated.

IT IS FURTHER ORDERED that the claimants as subcontractors and material furnishers who did not file any notice with the Owners are not entitled to any liens on any of the proceeds.

This the 22d day of August, 1957.

(s) RUFUS W. REYNOLDS,
Referee in Bankruptcy.

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[Caption omitted]

CERTIFICATE BY REFEREE TO JUDGE

I, Rufus W. Reynolds, Referee of said Court, do hereby certify that in the course of proceeding in the said cause before me, upon the hearing of claims of liens by material furnishers and subcontractors of the Bankrupt and the Director of Internal Revenue as to the amount, validity and priority, the following question was presented:

> Where Trustee for general contractors recovers balance due on construction contracts and the Director of Internal Revenue assesses taxes against the Bankrupt before bankruptcy and before subcontractors of the Bankrupt give notice of lien to Owners, who has prior lien, Director of Internal Revenue or subcontractors?

Upon considering the evidence I made findings as set out in the order as attached hereto. Said findings were made after considering the testimony, documentary evidence and argument of counsel.

WHEREUPON, on the 22nd day of August, 1957, I entered an order allowing the lien by the Director of Internal Revenue Senior to the subcontractors' liens, first satisfying the Director's liens from other assets in the bankrupts' estate.

WHEREUPON, petitions for review of said order by the Judge were filed by George H. Carter, Jr., formerly trading as Dixie Concrete and Supply Company, and Durham Lumber Company.

Attached to this certificate are the following documents:

1. Petition for Review by George H. Carter, Jr., formerly trading as Dixie Concrete and supply Company.
2. Petition for Review by Durham Lumber Company.

3. Petition by Chambers & McArthur to compromise judgment and apply payments on judgment.

4. Petition by Noland Company, Inc., to join Trustee as party in action.

5. Order approving compromise with Noland Company, Inc., and Adams Concrete Company.

6. Petition by Trustee to give material claimants notice to establish claims.

7. Order by Referee dated July 1, 1957, directing alleged material furnishers to establish liens.

8. Service of notice on alleged claim holders.

9. Notice to all creditors and alleged lien holders of hearing on claims for lien.

10. Proceedings of the action in State Court by Trustee against G. T. McArthur and R. L. Chambers.

11. Claims of liens as filed by:

(A) Durham Brazing and Welding Works
(B) Pedra Steel Company
(C) Lovette Electric Construction Company
(D) Nello L. Teer Company
(E) Durham Lumber Company
(F) George H. Carter, Jr., formerly trading as Dixie Concrete and Supply Company

12. Briefs as filed by:

(A) U. S. Treasury Department
(B) Durham Brazing and Welding Works

13. Letter from E. K. Powe, Attorney for the Bankrupt.

14. Letter from Daniel K. Edwards, Attorney for the Trustee.

15. Order entered by Referee, dated August 22, 1957, determining priority and amount of claim. (The order is combined with final distribution of

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funds on hand in order that a picture of the entire matter can be ascertained.)

This the 4th day of September, 1957.

(s) RUFUS W. REYNOLDS,
Referee in Bankruptcy.

[Caption omitted]

MEMORANDUM OPINION

HAYES, *District Judge:*

Exceptions to the order of the Referee in Bankruptcy were filed by Geo. H. Carter, Jr. formerly trading as Dixie Concrete and Supply Co., and Durham Lumber Co., in so far as the order gave the United States tax lien priority over them.

The Referee applied the doctrine of priority usually applicable to the distribution of assets belonging to the bankrupt and relied primarily on *United States* v. *White Bear Brewing Co.,* 350 U. S. 1010, reversing 7th Circuit in 227 Fed. 2d 359. There the bankrupt was the owner of real property which had been improved by a person asserting a mechanic's lien. Priority of liens as between the United States and such a claimant for a mechanic's lien was the issue determined.

In the instant case the owner is not the bankrupt; the contractor is the bankrupt. It is therefore necessary to determine whether the asset in question was the sole property of the bankrupt before the *White Bear* case, *supra,* applies.

The contractor (bankrupt) agreed to furnish and pay for all labor and materials and erect the improvements for a stated sum, free from all liens against the property.

When the contractor was adjudged a bankrupt, the work had been completed and a balance was due the contractor if the labor and materialmen's liens were discharged.

The trustee sued the contractor and obtained a judgment for the balance of the contract price. However, the two excepting creditors gave the statutory notice to the owner of the amounts due them by the contractor for labor and materials furnished by them in the performance of the contract. They did all required of them to establish a valid lien against the property of the owner—not the bankrupt contractor.

After the trustee obtained a judgment against the owner but before paying the judgment, the Superior Court, rendering the judgment, made an order, pursuant to the law of North Carolina, *Swiggins* v. *Buss Co.*, 230 N. C. 234, making these lien claimants parties to the original action. That court, with all the parties before it, required the defendant owner to pay over to the trustee the balance due, and transferred the liens to the fund and discharged the owner from their claims. The state court permitted the fund to come into the hands of the trustee impressed with such liens thereon as the claimants possessed, to be determined by the bankruptcy court. It was not provided in the order or implied in it, that the funds was an asset of the bankrupt free from the liens of these claimants.

Since the state court discharged the owner from these claims and transferred the liens to the fund, it

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follows that the fund in the possession of the trustee is subject to whatever valid liens existed at the time of the transfer. Under the law of North Carolina, where a laborer, materialman or subcontractor gives the required statutory notice to the owner his lien immediately attaches to any balance due by the owner to the original contractor, and payment to the contractor thereafter will not discharge the owner from the lien of such a claimant. The fund was required by the law of North Carolina to be applied first in discharge of these liens before it became an asset of the bankrupt contractor. *Schnepp* v. *Richardson,* et al., 222 N. C. 228; *Assurance Society* v. *Basnight* et al., 234 N. C. 347.

The usual order of distribution of the assets of a bankrupt undoubtedly controls the disposition of assets owned by the bankrupt but cannot be enlarged to include assets not belonging to the bankrupt. *Fidelity and Deposit Co.* v. *New York City Housing Authority,* 241 F. 2d 142 2d cir. 0. The exceptions are allowed and the order of the Referee is modified accordingly.

This the 14th day of October 1957.

(s) JOHNSON J. HAYES,
United States District Judge.

Exception allowed to the United States October 14, 1957.

HAYES, *Judge.*

In the United States Court of Appeals for the Fourth Circuit

No. 7619

UNITED STATES OF AMERICA, APPELLANT

versus

DURHAM LUMBER COMPANY, A CORPORATION, AND GEORGE H. CARTER, JR., FORMERLY TRADING AS DIXIE CONCRETE AND SUPPLY COMPANY, APPELLEES

IN THE MATTER OF AUBREY H. MICHAEL & EDWARD L. EMBREE, JR., IND. AND T/A MICHAEL & EMBREE, CONTRACTORS, BANKRUPT

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA, AT GREENSBORO

(Argued April 15, 1958. Decided July 18, 1958)

Before SOBELOFF, *Chief Judge,* HAYNSWORTH, *Circuit Judge,* and PAUL, *District Judge*

Louise Foster, Attorney, Department of Justice (Charles K. Rice, Assistant Attorney General; Lee A. Jackson and A. F. Prescott, Attorneys, Department of Justice; Robert L. Gavin, United States Attorney, and Lafayette Williams, Assistant United States Attorney, on brief), for Appellant; Arthur Vann for George H. Carter, Jr., etc., Appellee; and Daniel M. Williams, Jr., for Durham Lumber Co., Appellee.

HAYNSWORTH, *Circuit Judge:*

This appeal presents a question of the relative rights of the United States, claiming under a tax lien upon the properties of a general contractor, and certain subcontractors, claiming in their individual rights

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against the owners of improved real estate. The District Court held, we think properly, that the subcontractors had the prior right in the particular fund.

Michael & Embree, general contractors, completed certain construction work in July 1954, but the owners disputed the amount of the balance due under the construction contract. Shortly thereafter, uncollected taxes were assessed to the general contractor, upon the basis of which a lien arose, in favor of the United States, upon all of the general contractor's property and rights to property. Internal Revenue Code of 1954, § 6321 (26 U. S. C. A. § 6321). Later, certain subcontractors, who had not been paid, filed with the owners notices of their claims pursuant to the provisions of the General Statutes of North Carolina, § 44–9. Meanwhile, the general contractor-taxpayer had filed a petition in bankruptcy.

The Trustee in Bankruptcy brought an action against the owners for the balance claimed to be due on the construction contract and obtained a judgment in the Superior Court for Durham County, North Carolina, for $5,250.00. The owners thereupon petitioned the Bankruptcy Court for permission to satisfy the judgment, *pro tanto*, by paying subcontractors and materialmen who had filed appropriate notices with them. As a result of extensive negotiations in which the subcontractors participated, the parties agreed to petition the Superior Court to reopen the case there, join the subcontractors as parties and enter an order which would permit the owners to pay to the Trustee the balance due, without prejudice to the rights of the subcontractors in the fund. An appropriate order was entered purporting to preserve the claims and rights of the subcontractors but substituting as the obligor the fund in the hands of the

Trustee in the stead of the owners and their improved property.

The Government frankly states that it was understood that the conflicting rights of all parties would be determined in the Bankruptcy Court as if the matter, with all proper parties, was still in the state court. We, thus, need not be concerned with the subsequent procedures, but are required to consider the conflicting claims of the United States and the subcontractors as if the owners had continued to withhold payment of the amount of the judgment.

The Referee concluded, as a matter of law, that the rights of the United States under its tax lien were superior to those of the subcontractors. The District Judge disagreed and, accordingly, modified the order of the Referee.

There is no doubt of the priority of the Federal tax lien over a mechanic's lien when the two liens attach to the same property. A mechanic's lien is not one of those preferred interests to which the Congress has extended priority over the tax lien. Internal Revenue Code of 1954, § 6323 (26 U. S. C. A. § 6323). *United States* v. *White Bear Brewing Co., Inc.*, 350 U. S. 1010, 76 S. Ct. 646, 100 L. Ed. 871. If the owner, rather than the general contractor, had been the delinquent taxpayer, the Federal tax lien reaching all of the owner's property, would outrank the claims of subcontractors, whether or not those claims had been protected with perfected mechanic's liens. It is equally clear that any claims of the subcontractors against the general contractor-taxpayer are subordinate to the tax lien attaching to all of the general contractor's property. But we are confronted with a different situation, one which calls for an examination of the nature of the right of the subcontractor,

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as asserted in North Carolina, against the owner of the improved property.

Prior to 1874, the statutes of North Carolina provided a lien upon improved real estate to secure the payment of "all debts contracted for work done on the same, or material furnished." Preservation of the lien was, contingent upon a timely filing of a notice in the office of the Clerk of the Superior Court and a timely institution of an action to enforce the lien. This is still the statutory scheme for the protection of the rights of general contractors. General Statutes of North Carolina, §§ 44–1, 44–38, 44–39, 44–40, 44–43.

In 1874, however, it was held in *Wilkie* v. *Bray*, 71 N. C. 205, that the statute created liens only for the benefit of persons in privity of contract with the owner and that no lien was created for the protection of a subcontractor This decision led to a series of new statutes conferring new rights upon subcontractors and creating new interests for their protection. See *Morganton Mfg. & Trading Co.* v. *Anderson*, 165 N. C. 285, 81 S. E. 418; *Lester* v. *Houston*, 101 N. C. 605, 8 S. E. 366; *Charlotte Pipe & Foundry Co.* v. *Southern Aluminum Co.*, 172 N. C. 704, 90 S. E. 923.

The statutes adopted after 1874, expressly created a lien for the protection of subcontractors which is preferred to that arising in favor of the general contractor.[1] The general contractor, before receiving any payment from the owner, is required to file with the owner a statement of all sums due subcontractors and the owner is directed to pay such sums directly to the subcontractors rather than to the general contractor.[2] A contractor who fails to furnish such a statement is

[1] General Statutes of North Carolina, § 44–6.

[2] General Statutes of North Carolina, § 44–8.

guilty of a misdemeanor,[3] but, whether he does or not, a subcontractor may furnish the owner with a statement of his account. If he does so, a lien immediately arises in his favor, and, thereafter, no "payment to the contractor shall be a credit on or a discharge of the lien * * * "[4] The requirement that notice of the lien be filed in the office of the Clerk of the Superior Court is made inapplicable, notice to the owner being all that is required.[5] The lien, as an interest in the real estate of the owner, is extinguished if the subcontractor does not commence an action to enforce it within six months after the notice,[6] but the requirement that the owner make payment to the subcontractor in preference to the general contractor remains in effect, and the subcontractor may maintain an action against the owner, at any time within the period of general limitations, to compel compliance with that duty.[7]

It is clear that under the North Carolina statutes the subcontractor who notifies the owner of his claim has (1) a lien upon the improved real estate superior to any lien which the general contractor may obtain, and (2) an independent cause of action against the owner, maintainable in his own name, and in his own right, without regard to the time limitations upon the commencement of suit to enforce a lien, and the owner, after notice, may not avoid or reduce his direct

[3] General Statutes of North Carolina, § 44–12.

[4] General Statutes of North Carolina, § 44–9.

[5] General Statutes of North Carolina, § 44–10.

[6] *Hildebrand* v. *Vanderbilt*, 147 N. C. 639, 61 S. E. 620.

[7] *Hildebrand* v. *Vanderbilt*, 147 N. C. 639, 61 S. E. 620; *Charlotte Pipe & Foundry Co.* v. *Southern Aluminum Co.*, 172 N. C. 704, 90 S. E. 923; *Guilford Lumber Mfg. Co.* v. *Holloday*, 178 N. C. 417, 100 S. E. 597; *Campbell* v. *Hall*, 187 N. C. 464, 121 S. E. 761; *Schnepp* v. *Richardson*, 222 N. C. 228, 22 S. E. 2d 555.

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liability to the subcontractor by any payment to, or settlement with, the general contractor. In any settlement with the general contractor, the owner may take credit for payments made by him to subcontractors, and he is required by statute to withhold sufficient funds to pay all of the claims of subcontractors of which he has notice. The obligation of the owner to the subcontractor is, thus, primary; his obligation to the general contractor, secondary.[8]

The subcontractor also has a claim against the general contractor. If we consider only this aspect of his right and if the subcontractor was proceeding in aid of his right to payment by the general contractor, this case would present no difficulty. The tax lien is clearly entitled to priority over the general claims of subcontractors seeking payment out of the property or interests in property of the general contractor, to which the tax lien has attached. But to define the right of the general contractor to receive payment of the contract price, subject, as we have seen, to the prior rights of subcontractors, as a property right reached by the tax lien does not convert this case into one of simple solution upon application of the established principle that the tax lien has priority over a mechanic's lien when both attach to the same property. We may not ignore the facts that the tax lien reaches the properties of the general contractor, not those of the owners, and that the independent rights of the subcontractors are asserted against the owners and their properties, not against the taxpayer or its properties. The priority of the tax lien in the division

[8] The limitation that the aggregate of the owner's liabilities to subcontractors may not exceed his contract obligation is of no moment here, for the amount still due by the owners was more than sufficient to pay the outstanding claims of the subcontractors.

and distribution of the properties of the taxpayer, to which it attaches, is not to be extended to a like priority in the division or distribution of the properties of the taxpayer's debtor, to which the tax lien does not reach. Nor should the tax lien on the properties of the taxpayer extinguish private rights and liabilities as between other persons who do not claim through or in the right of the taxpayer.

As the statutes of North Carolina expressly provide, the owners may not discharge their debt to the subcontractors, of whose claims they have notice, by any payment to the general contractor. This is true whether or not the general contractor reduces his claim to judgment and whether or not the United States, through a tax lien, has become one of the "owners"[*] of the claim of the general contractor. The subcontractors are still entitled to proceed against the owners and to payment of their claims out of the assets of the owners. Should the owners answer such a suit with a plea in bar that the claim of the general contractor had been acquired by the United States under a tax lien, it would stand on no higher plane than a plea of voluntary payment to the general contractor. Seizure by the United States under a tax lien of the claim of the general contractor cannot extinguish the statutory rights and obligations of a subcontractor and a North Carolina owner as between each other.

This is the right asserted by the subcontractors here. They do not seek payment out of the properties of the general contractor which are subject to the tax lien. Their claims are addressed to the owners. To the extent that the owners may be allowed to take credit for the amount of their claims in any settle-

[*] *United States* v. *City of Greenville*, 4 Cir., 118 F. 2d 963, 965.

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ment with the general contractor, the existence of the claims are relevant to an appraisal of the worth of the claim of the general contractor. That is a consequence of the nature of the rights as created and limited by the statutes, but it does not force the subcontractor to look to the assets of the general contractor, rather than to those of the owner, for satisfaction of his claim. Nor does it permit us to deny enforcement of the subcontractors' statutory rights against solvent owners. At the most, it can mean only that, except to the extent the claim of the general contractor exceeds the aggregate of the claims of the subcontractors, the general contractor has no right which is subject to seizure under the tax lien.

That was the conclusion of the Court of Appeals for the Second Circuit in Fidelity and Deposit Company of Maryland v. New York City Housing Authority, 2 Cir., 241 F. 2d 142. There it was carefully pointed out that it is a federal function, in applying federal revenue laws, to classify state-created rights and interests and to determine their relative priorities, but the rights and interests themselves are creatures of the state. If the delinquent taxpayer has no right under state law, there is nothing upon which the tax lien may attach. The court there found that the provisions of the general construction contract, under the laws of New York, created a preference for the claims of subcontractors, asserted against the owner, over those of the general contractor-taxpayer, and, therefore, concluded that the general contractor-taxpayer had no right which the tax lien could reach. The more decided preference, under the laws of North Carolina, of the claims of the subcontractors leads us to the same conclusion.

The only question recognized as being before the court in the earlier case of *United States* v. *Kings*

County Iron Works, 2 Cir., 224 F. 2d 232, was the one of relative priority of competing claims to the same fund. In such a contest, the tax lien must always be the victor over the claims of subcontractors. Later, however, when the very different situation with which we are confronted was clearly presented to the same court in the Fidelity and Deposit case, it was recognized that the tax lien may prevail over the claims of subcontractors only when they compete for recognition in the same property or right.

In *Aquilino* v. *United States,* 3 N. Y. 2d 511, 146 N. E. 2d 774, the New York Court of Appeals reached a conclusion apparently at variance with our own. The opinion indicates no awareness of the decision in the Fidelity and Deposit case, but construed Kings County Iron Works to stand for the proposition that the tax lien on the property of the general contractor would prevent the assertion of the rights of subcontractors against the owner. Had the New York Court of Appeals been informed of the decision of the Court of Appeals for the Second Circuit in Fidelity and Deposit, indeed had it felt at liberty to accord full recognition to the state-created right of the subcontractor against the owner, it may have reached a different conclusion.

That the Court of Appeals of New York should have accorded greater recognition to the state created rights is strongly indicated by the very recent case of United States v. Bess, —— U. S. ——, —— S. Ct. ——, —— L. Ed. —— (decided June 9, 1958) in which it was held that the tax lien could attach only to such rights as had been created and limited by state law. Section 3670, it was said, merely attaches federally defined consequences to state created rights.

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In stating the proposition, the Supreme Court cited with approval the decision of the Court of Appeals for the Second Circuit in *Fidelity and Deposit, supra.* Had the New York Court of Appeals adopted the same approach in *Aquilino,* it hardly could have avoided the conclusion that where the state created right of the general contractor was at all times secondary and subordinate the attachment of the tax lien does not elevate it to a status of primacy and preference.

The rights of the subcontractors as here asserted against the owners are not liens. Each of them acquired a lien on the real estate of the owner when he gave notice of his claim, but no one of them instituted an action to foreclose the lien within six months after the notice, and they may not now do so. But their statutory right to payment by the owner persists and may be enforced by them. Their claims are preferred to that of the general contractor, but, with respect to others, their standing is that of a common creditor of the owners. But theirs is a valuable right which is not extinguished by the tax lien on the property of the general contractor, whose only claim against the owners under the laws of North Carolina, is for so much of the construction price as will remain unpaid after the owners have deducted a sum sufficient to pay the subcontractors.

We agree with the District Judge that the balance of the construction price should be applied first to payment in full of the claims of the subcontractors, and then only may the remainder be disbursed as an asset of the bankrupt estate.

Affirmed.

Decree

Filed and Entered July 18, 1958

In the United States Court of Appeals for the Fourth Circuit

No. 7619

United States of America, appellant

vs.

Durham Lumber Company, a Corporation, and George H. Carter, Jr., Formerly Trading as Dixie Concrete and Supply Company, appellees

In the Matter of Aubrey H. Michael & Edward L. Embree, Jr., Ind., and T/A Michael & Embree, Contractors, Bankrupt

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA

This cause came on to be heard on the record from the United States District Court for the Middle District of North Carolina, and was argued by counsel.

On consideration whereof, It is now here ordered, adjudged and decreed by this Court that the order of the said District Court appealed from, in this cause, be, and the same is hereby, affirmed.

Simon E. Sobeloff,
Chief Judge, Fourth Circuit.

Clement F. Haynsworth, Jr.,
United States Circuit Judge.

John Paul,
United States District Judge.

Filed July 18, 1958.

R. M. F. Williams, Jr., *Clerk.*

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August 19, 1958, mandate issued and transmitted to the Clerk of the United States District Court at Greensboro, North Carolina.

August 19, 1958, record on appeal returned to the Clerk of the United States District Court at Greensboro, North Carolina.

APPENDIX B

Internal Revenue Code of 1954:

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U. S. C. 1952 ed., Supp. V, Sec. 6321.)

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, and the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

(26 U. S. C. 1952 ed., Supp. V, Sec. 6322.)

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITOR.

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under State or Territorial Laws.*—In the office designated by the law of the State or

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Territory in which the property subject to the lien is situated,whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) *With Clerk of District Court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; * * *

* * * * *

(26 U. S. C. 1952 ed., Supp. V, Sec. 6323.)

General Statutes of North Carolina (Recompiled 1950):

SEC. 44–1. *On buildings and property, real and personal.*—Every building built, rebuilt, repaired or improved, together with the necessary lots on which such building is situated, and every lot, farm or vessel, or any kind of property, real or personal, not herein enumerated, shall be subject to a lien for the payment of all debts contracted for work done on the same, or material furnished.

* * * * *

SEC. 44–6. *Lien given subcontractors, etc., on real estate.*—All subcontractors and laborers who are employed to furnish or who do furnish labor or material for the building, repairing or altering any house or other improvement on real estate, have a lien on said house and real estate for the amount of such labor done or material furnished, which lien shall be preferred to the mechanic's lien now provided by law, when notice thereof shall be given as hereinafter provided, which may be enforced as other liens in this chapter, except where it is otherwise provided; but the sum total of all the liens due subcontractors and materialmen

shall not exceed the amount due the original contractor at the time of notice given.

* * * * *

SEC. 44–8. *Statement of contractor's indebtdness to be furnished to owner; effect.*—When any contractor, architect or other person makes a contract for building, altering or repairing any building or vessel, or for the construction or repair of a railroad, with the owner thereof, it is his duty to furnish to the owner or his agent, before receiving any part of the contract price, as it may become due, an itemized statement of the amount owing to any laborer, mechanic or artisan employed by such contractor, architect or other person, or to any person for materials furnished, and upon delivery to the owner or his agent of the itemized statement aforesaid, it is the duty of the owner to retain from the money then due the contractor a sum not exceeding the price contracted for, which will be sufficient to pay such laborer, artisan or mechanic for labor done, or such person for material furnished, which said amount the owner shall pay directly to the laborer, mechanic, artisan or person furnishing materials. The owner may retain in his hands until the contract is completed such sum as may have been agreed on between him and the contractor, architect or other person employing laborers, as a guaranty for the faithful performance of the contract by such contractor. When such contract has been performed by the contractor such fund reserved as a guaranty shall be liable to the payment of the sum due the laborer, mechanic or artisan for labor done, or the person furnishing the materials as hereinbefore provided.

SEC. 44–9. *Subcontractors, laborers and materialmen may notify owner of claim; effect.*—Any subcontractor, laborer, mechanic, artisan,

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or person furnishing materials, who claims the lien provided for in this article for labor on, or materials furnished for, any building, vessel, railroad, or real estate, may give notice to the owner, agent or lessee who makes the contract for the labor or materials, of the amount due by the contractor to such claimant. The notice shall be in the form of an itemized statement of the amount due, except where the contract is entire for a gross sum and cannot be itemized. Upon the delivery of the notice to the owner, agent, or lessee, the claimant is entitled to all the liens and benefits conferred by law in as full a manner as though the statement were furnished by the contractor. If the said owner, agent or lessee refuses or neglects to retain, out of the amount due the contractor under the contract, a sum not exceeding the price contracted for which will be sufficient to pay such claimant, then the claimant may proceed to enforce his lien, and after such notice is given no payment to the contractor shall be a credit on or a discharge of the lien herein provided for.

SEC. 44–10. *Sums due by statement to constitute lien.*—The sums due to the laborer, mechanic or artisan for labor done, or due the person furnishing materials, as shown in the itemized statement rendered to the owner, shall be a lien on the building, vessel or railroad built, altered or repaired, without any lien being filed before a justice of the peace or the superior court.

SEC. 44–11. *Where sums due contractor from owner insufficient; payment pro rata.*—If the amount due the contractor by the owner is insufficient to pay in full the laborer, mechanic or artisan, for his labor, and the person furnishing materials, for materials furnished, it is the duty of the owner to distribute the amount pro rata among the several claimants, as shown by the itemized statement furnished

the owner, or of which notice has been given the owner by the claimant.

* * * * *

SEC. 44–38. *Claim of lien to be filed; place of filing.*—All claims against personal property, of two hundred dollars and under, may be filed in the office of the nearest justice of the peace; if over two hundred dollars or against any real estate or interest therein, in the office of the superior court clerk in any county where the labor has been performed or the materials furnished; but all claims shall be filed in detail, specifying the materials furnished or labor performed, and the time thereof. If the parties interested make a special contract for such labor performed, or if such material and labor are specified in writing, in such cases it shall be decided agreeably to the terms of the contract, provided the terms of such contract do not affect the lien for such labor performed or materials furnished.

SEC. 44–39. *Time of filing notice.*—Notice of lien shall be filed as hereinbefore provided, except in those cases where a shorter time is prescribed, at any time within six months after the completion of the labor or the final furnishing of the materials, or the gathering of the crops.

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SEC. 44–43. *Action to enforce lien.*—Action to enforce the lien created must be commenced in the court of a justice of the peace, and in the superior court, according to the jurisdiction thereof, within six months from the date of filing the notice of the lien. But if the debt is not due within six months, but becomes due within twelve months, suit may be brought or other proceedings instituted to enforce the lien in thirty days after it is due.

SEC. 44–48. *Discharge of liens.*—All liens created by this chapter may be discharged as follows:

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4. By a failure of the claimant to commence an action for the enforcement of the lien within six months from the notice of lien filed.

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